North American Electric Utilities

EEI: The Final Day of our Virtual Exploration Tour

Price Objective Change

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Equity
North America
Electric Utilities

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So big surprises? No; but datapoints, plenty.

As we close out this year's EEI we appreciate that few companies provided material updates. That said numerous companies provided substantive incremental datapoints on their trajectories – and overall large-cap companies did well in de-risking their outlooks including D, DUK, SO, and NEE. While large-caps have done relatively well already this year, we perceive support for each of these discrete stories to bolster sector prospects. By contrast, among the lone more cautious updates was AEP's '21 EPS guidance release & 5-yr view, which painted a slowing view vs earlier elevated expectations. Among other companies offering more cautious updates on their prospects included FE and EVRG albeit both are already at substantial discounts. We perceive persistent confidence in CNP on its subsequent roll forward (with details on both ENBL and LDC strategy), and a positive clear read-thru to NI. We suspect both will continue to trend well. With LDCs in focus, we perceive BKH as warranting greater attention given initiation of an EPS CAGR & yet further positive capex revisions. Other smids such as IDA and POR offered confidence inducing updates on their prospects – with expectations still relatively lower for POR, we flag this as particularly compelling. Finally, with DTE among the most controversial equities into the EEI conference we see mgmt's ability to add cnofidenc to reaching the high end of '21 affirmed that lingering doubts on spin could drive yet a further pos re-rating. Meanwhile on rate case developments, PNW offered among the single updates for a constructive new rider to limit renewable lag but ACC acceptance is still key. See earlier write-ups from Day 1, Day 2 and Day 3 here.

So who were our latest meetings? Wednesdays Slate

We met with AY, ED, ES, HE, LNT, MGEE & WTRG yesterday to close out the conference. AY appears poised to provide substantial 4Q updates, likely slowing its DPS growth to a mid-single digit (see table below), from 8-10%. That said, buyout opportunities of partners and expansions at existing sites provide a rare opportunity for higher return opportunities for YieldCo. We stress its focus on smaller acquisitions too also lend themselves to sustained higher returns too. ED's new CEO was indeed impressive & thoughtful on expanding ED increasingly into renewables; its challenges in NY remain real with pressures on '21 EPS. ES was indeed positive – and whether it raises its outlook for a 6-8% EPS CAGR (or not), we see a clear bias to argue this company will achieve a 7% EPS CAGR through '25 when disclosed on 4Q call (formally rolling in transmission, CMA accretion, and smaller South Fork offshore wind project). With expectations higher, these developments appear largely appreciated by the market. Rather, more importantly, we perceive near-term confidence around draft net metering decision and forthcoming affirmation on BOEM permitting process as all boding relatively well for shares. As for LNT, we perceive confidence on substantial cost reductions & emphasize this aspect as a key point to enable yet further T&D spending (that was otherwise displaced with its 3Q updates with renewables taking its 'place' in its 5-year capex budget). On balance, our favorite defensive utility still. MGEE was indeed constructive on just how further coal retirements could meaningfully shift its outlook from cost structure – enabling yet larger capex program and potentially protracted rate case stayouts. Our ES PO shifts to $95 (vs. $90) on group multiples.

Refer to important disclosures on page 18 to 20. Analyst Certification on page 15. Price Objective Basis/Risk on page 13.

Contents

Alliant Energy (LNT)

Alliant mgmt. highlighted the meaningful rate of change ahead in the composition of its generation portfolio, with an estimated 14% of its 2020 rate base allocated to coal generation forecast to shift to 7% by 2030 following the retirement of Lansing, conversion to gas of Burlington, and in-servicing of currently planned renewables (1000 MW WI solar, 400 MW IA solar). Among the operational improvements driven by the evolving generation portfolio are meaningful reductions in O&M, with mgmt. targeting cuts of 3-5%/yr, among the more impressive cost cutting targets across our coverage. Maintain Buy on LNT as remains our favorite defensive utility idea.

Driving 3-5% O&M reduction through renewables build

With 1400 MW of solar scheduled to come on line in coming years along with pending retirements of Edgewater (414 MW in 2022), Lansing (275 MW in 2022), and conversion of Burlington (2021), LNT mgmt. flagged an impressive outlook for O&M reductions of 3-5% per annum through 2024 as high fixed cost generation is swapped for renewables. The majority of savings are expected to come from lower overhead associated with no longer operating coal generation (including lower headcount) as well as additional investments in technology and automation across the enterprise. We note that the overall trajectory of O&M reduction implies ~15% aggregate savings over the course of the forecast period, one of the more impressive cost reduction trajectories across our coverage. Following the latest announcements of coal retirements and conversions in Iowa, mgmt. continues to evaluate the rest of its coal burning fleet to determine if and when an accelerated retirement is appropriate (coal rate base expected to fall from 14% to 7% of total through the decade). We note that MGEE mgmt. has been discussing potentially accelerating the retirement of Columbia generating (which is co-owned by LNT, MGEE, and WEC) though LNT mgmt. has stressed that it continues to evaluate plant productivity with needed future investments in deciding whether or not to accelerate a retirement.

Cash tax runway until 2024, steady balance sheet improvement seen

LNT mgmt. sees itself as not paying cash taxes based on its current appetite and tax credit profile until 2024. Mgmt. is not currently making any assumptions about potential monetization of investment tax credits in the event that such a provision were passed as part of a stimulus bill – the expectation remains that the federal government is reluctant to pick winners in terms of fuel type when crafting tax policy as it pertains to renewable generation. In terms of the balance sheet, LNT sees its FFO metrics improving over the course of the forecast period with current levels in the 'mid teens' (our forecast sees a range from 16-18% through 2024).

Clear path to 5-7% through 2024

While we attribute some of LNT shares' underperformance in the week following the Q3 announcement to lingering expectations of a capex increase at the roll-forward, we now sense that investors have largely come to appreciate that the composition of spending is weighted toward renewables in the near part of the forecast period, with a corresponding shift toward more distribution spend in later years. With no block equity in the current forecast and robust O&M reductions targeted, we continue to see LNT as one of the best-positioned Midwest utilities looking ahead.

Atlantica Sustainable Infrastructure (AY)

We continue to question the yieldco ESG re-rating trend, given the level of growth prospects that has been priced into shares across the sector. With AY expected to announce '21 guidance and a LT growth CAGR next quarter, we remain skeptical around ability to maintain 8-10% DPS growth. That said, mgmt expects AY's valuation to be supported by $200-$300mn of annual investment, at high-single-digit to low-double-digit returns, and an 80% payout; if achievable, this could admittedly help support div growth. The critical question will be whether the opportunities exist. In European markets, we note several administrations pushing for infrastructure programs with renewable components. The U.S., similarly, may provide a supportive environment for renewable development. The other question will be the level of support received from AY's sponsor AQN, given their own current issues. We would expect less support from AQN near-term, although in the longer term this may change. Maintain Neutral.

How to justify the yieldco re-rating trend?

Our meeting focused firstly on the latest yieldco re-rating trend, with questions on being able to justify current valuations in the sector. Mgmt expects AY's valuation to be supported by growth, with $200-$300mn of investments annually, including in 2020 thus far. Finding opportunities with an adequate return profile will be the key challenge, given declining returns across the renewables space. Mgmt did note that while returns have seen compression over the last couple of years, the recent declines in interest rates have helped to make returns somewhat more justifiable. A higher share price should further help to reduce dilutive impact of dropdowns partially funded with equity issuance. Assuming a high-single-digits levered return on equity investment and an 80% payout on ~$250mn annual investment and employing 3.3x CAFD/Debt, we perceive AY could potentially stand to grow at **~4% annual DPS**; suspect a substantially moderated growth rate from 8-10% given reduced usage of HoldCo debt. We note the $200-300 Mn is a placeholder but mgmt. appears abundantly confidence it can execute at this scale with its current employee base. However, the critical question will be whether sufficient opportunities exist today to generate this level of investment at adequate returns.

Exhibit 1: Placeholder drop down math

Drop Down Math			
		HoldCo Debt	74.25
Share Price	30	Debt/CAFD	3.3x
Midpoint of CAFD	250	Shares Issued (ex-Debt)	5.86
CAFD	22.5	Dilution (% Shares)	5.74%
CAFD Yield	9%	DPS Dilution =>	0.10
80% DPS Payout	18	Interest Expense	0.03
DPS Upside	0.176471	Debt Coupon	5%
Current Div	1.68	Financing Costs (EPS Terms)	*0.12*
Div % Inc (Pre-Financing)	0.105042	DPS Upside	0.05
		DPS Accretion @ 80%	3%
		DPS Accretion @ 100% payou	6%

Source: BofA Global Research, Bloomberg

Growth prospects and return expectations across geographies: watch for expansions & buyouts of partners *to continue*

In the U.S., Atlantica targets high single digit returns, while in international markets, the target is in the low double digits in certain geographies. In European markets, we see several administrations pushing infrastructure programs with renewable components which could drive growth for AY (given strong Spanish base with solar asset portfolio). In the U.S., as well, a potential Biden administration could boost growth prospects through improved returns and opportunities. We note AY's continued expansion in North American markets with its first investment in Canada, a $20mn district heating investment. Separately, we highlight room for several more "niche opportunities" akin to the recent Solana tax equity investor buyout (we note peers including CWEN have also entered this area with re-powerings of existing projects).

Growth: Dropdowns vs. third-party partnerships vs. M&A

Atlantica noted several avenues through which to pursue growth, including investments to develop existing assets, partnerships with developers and construction companies (e.g. Algonquin, etc.), and third-party M&A through competitive deals. While AY expects that partnerships may comprise a smaller portion of growth in the short term (as partners are still developing their portfolios), longer term they are expected to make up a greater portion of the overall development pipeline.

Consolidated Edison (ED)

Con Ed's incoming CEO presented his vision for the company that largely builds on the strategic direction of the utility and non-reg business to date. At the regulated utilities the near term challenge remains managing the financial and operational impacts of Covid which are expected to persist into 2021 (and led to the recent '20 guidance cut). At the Clean Energy Business, the company continues to target investments of $400m/yr with an expectation to pivot to greater reliance on tax equity given its $800m backlog of accumulated tax credits as well as pursuing develop-build-flip projects that are less capital intensive. Incremental renewable investment opportunities were laid out for the regulated business as well, though the EV 'make ready' initiative had been previously known and battery storage potential remains in early days. Maintain Neutral on ED; we were impressed by the incoming CEO's eloquent description of future strategy – and efforts to expand renewable mandate but perceive pressures as likely to persist into 2021. We see question as still pending around future gas strategy, pressures from lost fees persisting into '21, and a regulatory backdrop that remains at an elevated risk (into 1Q21 O&R rate case filing). On balance, we perceive challenges ahead prior already reflected in its discount to peers.

2021 drivers: deferring bad debt, uncertain on foregone fees

We expect that per its usual schedule ED will provide forward guidance for 2021 with its Q4 update next Feb. Company mgmt. Among the key updates in the company's Q3 results is the deferral of Covid-linked bad debt expense – the uptick in expense reached $46m at the Con Ed Co of NY (CECONY), surpassing the materiality threshold of $20m that is part of ED's rate plans and allowing full deferral of the expense item to be considered in the next rate case filing (2022). Mgmt. indicated that it expects to defer these expenses in '21 as well, not surprising given the q/q uptick of $30m in bad debt expense as of Q3. Less obvious is whether foregone fees will be deferred in 2021 given the uncertain duration of the prohibition on charging fees to residential customers affected by Covid – recall this was the change in law (Cuomo exec orders) that drove the deferral of bad debt expense. ED estimates that it is losing $6.4m in fees *per month* during the pandemic, with an estimated half of that attributed to residential customers (though not clear how many of those are directly attributable to Covid). As we previously indicated in our updated estimates, we expect 6 months' of lost fee revenue and direct Covid expenses to impact ED by -7c, with an additional -7c due to lower Steam demand (TTM earned ROE at the Steam business is 5.6% as of Q3).

Table 1: EPS forecast

ED 2021 EPS Walk	EPS	Note
Start: 8.8% earned ROE	4.54	Based on CECONY earning full authorized
Less: foregone fees 6 months	(0.04)	6 months' impact, $6.4m revenue per month
Less: direct Covid expenses	(0.03)	Q2 impact was ($0.06)
Less: higher bad debt expense	-	Now deferred
Less: Steam lower demand	(0.07)	
BofA 2021 EPS estimate	4.40	

Source: BofA Global Research estimates

Renewable opportunities: EV station build out, still early on utility-scale storage

Incoming management flagged the opportunity to add to rate base meaningfully over the coming years via a number of renewable energy initiatives that are not fully captured in the current rate base forecast. We previously incorporated the EV 'Make Ready' charging station program into our forecasts, with an estimated EPS impact ranging from $0.02-0.04/yr based on ED's $314m of capex allocated to the program.

Table 2: Make-Ready Spend Detail

	State total	CECONY	O&R	ED Total	Central Hudson	NYSEG	Niagara Mohawk	RG&E
Level 2 Plugs	95	42	16	58	18	51	87	23
DC Fast Charger	386	192	4	195	3	13	25	8
Incentive	480	234	19	253	21	64	112	31
Futureproofing	38	19	2	20	2	5	9	2
Implementation	72	35	3	38	3	10	17	5
Transit Authority	10	3		3			5	2
Total	601	290	24	314	26	78	143	40

Source: BofA Global Research estimates

Near-term upside from spending opportunities on utility-scale storage is less obvious though mgmt. reports high-level discussions with state regulators including the New York State Energy Research and Development Authority (NYSERDA). Among the structures under consideration is a partnership with private developers whereby battery storage is developed and utility-owned for a period of 7-10 years after which ownership would revert to the developer, with initial procurement estimated in the 300 MW range in ED's service territory. We note that conversations around this remain in early stages without a formal proposal, though we do expect acceleration of renewable and storage solicitations (ED estimates ~2.5 GW of renewables needed annually to reach state interim decarb goals by 2030).

Essential Utilities (WTRG)

Management Successfully Navigating COVID & Peoples Integration

Following their positive 3Q report last week in which management reaffirmed full year guidance of $1.53-$1.58 - noting expectations to be at the top end of the range and affirmation of their 5-7% EPS growth through '22 - latest discussions with management stressed confidence around execution of their strategy with the company successfully navigating the pandemic while integrating their Peoples Gas acquisition. Recall the company has elected to use Repairs Tax accounting treatment and has effectively implemented the last several months – with guidance of $0.08-$0.12 benefit annually. We await developments around the regulatory process of the catch up component after the earlier filing, with resolution expected early in April of 2021. Rather than drive incremental upside to their 5-7% EPS CAGR, the filing seeks to extend the growth without a need for a rate case. As opposed to going in for new rates in 2023 to take effect in 2024, a constructive outcome from the catch up filing would benefit '23, with incremental benefits in '24, and '25 to help drive earned returns for the segment in outer years without any rate relief until 2026. Bottom line, the repairs tax debate boils down to Peoples Gas ROE lag in '23, likely to a modest degree. Focus on EPS growth roll-forward to '23 (presumably with 4Q) will be of importance. Given the uncertainties in the outlook mgmt. intends to limit its roll forward to a 3-year outlook in spite of peers having a 5-year outlook. On balance we feel comfortable in mgmt's ability to manage lag around its ROEs at core water utilities including PA into a potential water filing next year.

Muni Pipeline Remains Strong amid pending DELCORA developments

With FMV legislation now in all eight water & wastewater states in WTRG's footprint following the passage in Virginia earlier this year, the company continues to execute on tuck in acquisitions and discussions continue to highlight a robust pipeline of opportunities. The company has already closed on Campbell, East Norriton, and Rockwell Utilities this year, with another ~353Mn of rate base opportunities from signed APAs expected to generate an additional ~$18Mn of earnings potential. Meanwhile, the company is actively pursuing acquisition opportunities across all of their water geographies, with ~360K customers identified, the majority being wastewater. We expect more firm announcements in coming weeks.

We see the latest pressures put on munis from the ongoing pandemic as likely to only further accelerate consolidation in the industry. Meanwhile, a further environmental push under a Biden administration could provide additional capital opportunities as compliance costs with PFAs and water quality concerns have already started contributing to the push away from muni owned water systems.

Management remains confident on the DELCORA process, with a regulatory approval expected in mid-March. This would put the company on track to potentially close the transaction in April or May after the 30 day appeal window. Meanwhile, a hearing is scheduled for early December regarding the litigation around the trust with a ruling expected from the judge within 60 days. Recall the company has until August to pull on the ~$300Mn equity forward to be used for DELCORA and other acquisitions.

We reiterate our Buy rating, seeing upside risk in the event of better than expected execution on their long-term growth rate.

Eversource Energy (ES)

Poised to Extend with Upcoming Roll Forward: Q'n is Just How Much Upside?
Following their 3Q report last week in which ES management reaffirmed full year guidance of $3.60-$3.70 (excluding full year costs related to the recently completed acquisition of Columbia Gas of Massachusetts) and its long-term EPS growth rate from its core regulated business of 5-7%, latest discussions with management continued to stress confidence around the trajectory of the company. While still unclear if it will formally raise to 6-8% trajectory, it is clear mgmt. will pivot to high end of its EPS growth rate by 4Q with inclusion of both smaller offshore (South Fork) likely alongside inclusion of CMA and potentially modest capex. We see a positive near-term tailwind between offshore wind trends and otherwise constructive updates. Management plans to roll forward their five year outlook through 2025 with full year results, with inclusion of Columbia Gas and some added capex from annual updates across their businesses including some transmission projects incremental to the plan. We perceive another ~$50Mn in transmission spend vs. what was previously contemplated; meanwhile, new MA legislation allowing the expansion of utility-owned solar generation is awaiting conference committee after being enacted in the House: this would allow utilities to own up to 10% of solar amount on its system, suggesting 230MW permitted for NSTAR Electric that would be incremental to the plan. We don't necessarily anticipate offshore wind or AMI to be firmly included with the update given a lack of clarity around approvals and timing, but nonetheless could see management point to a higher range from just the CMA accretion given the low acquisition price of 1x rate base. Expectations are for CMA alone to be accretive this quarter with further incremental accretion each year. It remains unclear if management would formally shift up guidance as opposed to pointing to the higher end given additional opportunities not yet formally included.

Offshore Protracted, but Upside Here too Quite Possible
After early commentary from Orsted around offshore delays, ES indicated changes in expectations around most recent in service dates of end of 2023 for South Fork wind (vs. End of 2022 previously), that it is unlikely to achieve end of '23 in-service date previously alluded to for Revolution Wind, and that it is unlikely to achieve the end of '24 in-service date for Sunrise Wind. Following the BOEM review schedule for South Fork Wind, the COP decision is due in January 2022 while the BOEM review schedule for Revolution Wind is now expected in early '21 (vs. late this year previously). After filing the COP application for Sunrise wind, the BOEM review schedule is expected in 2021. We see 2026 as entirely possible – and therefore outside of the 5-year window for the 2021-2025 CAGR roll forward. Management expects news from BOEM around Vineyard Wind shortly to help provide further clarity on their projects.

That said, a growing consideration is improvements to the economics of the projects: commentary from management highlighted that delays have provided latitude for better tech and we see improving O&M as another interesting nuance. It remains to be seen how prospects can further improve under a Biden administration given his support for offshore wind. We could yet see extensions for tax credits & inclusions for offshore wind and we perceive potential appetite for ITCs through 2025.

While current projects face delays on the margin, the company has capacity to build 4GW (with the JV representing 1.7GW) as they look to optimize their local expertise, and Orsted and ES announced their joint proposal to develop Sunrise Wind 2 (a new offshore wind farm for New York State). We perceive there may have only been three bidders for the project and quite possible multiple bids are awarded.

We see near-term resolution around low income rates in CT and storm response as key to enabling re-rating of shares higher. While we could yet see penalties accrue around Isaias, we stress the watered down Take Back our Grid Act in Connecticut was ultimately much less punitive than initially feared. We raise the PO from $90 to $95 on higher group electric/gas multiples (17.3x/15.3x) vs. prior (16.5x/13.8x)   Maintain Neutral given we see balanced risk/reward.

That said, we look for resolution around potential latest proposed decision in net metering tariff adjustment that would reduce rates in CT. Management remained confident in its ability to recover lost revenues from NEM in final order. Watch this in coming weeks to drive shares given $16Mn+ impact.

Hawaiian Electric Industries (HE)

Sustained cost reductions remains a key focus area ahead

With discussions, mgmt focused on sustaining cost reductions into '21+. Mgmt expressed a focus on sustained cost savings with the PUC mgmt audit. Among key cost levers expressed include strategic sourcing (renegotiating supply agreements with vendors, etc), work force reduction strategy (reduced overtime and improved scheduling coordination), process improvements, and other cost efficiency to lower cost of services.

That being said, in terms of O&M reductions to date, mgmt acknowledges meaningful portion (half of 3Q) associated with delayed but needed generation overhauls and station maintenance work, effectively timing shifts into 4Q and 1Q21 with FY20 utility guidance remaining at the bottom half of the range despite YTD performance. On a forward basis, mgmt express ability to keep O&M at or below inflation as key to forward performance beyond commitments of $25mn in annual cost reductions.

<u>On balance a constructive meeting when considering both O&M tailwinds discussed from latest cost cuts pursued as well as potentially bottoming out on ASB. That said, clear pressures exist into '21 to drive EPS pressures vs Street. We maintain our Underperform pending clarity on critical PBR reforms ahead in coming weeks – this will be the single most important datapoint for shares in years.</u>

PBR key focus on potential to reduce structural lag towards 9.0%

Among notable commentary, mgmt expressed potential opportunity to improve earned ROEs towards 9.0% (relative to authorized ROE of 9.5%) following the conclusion of PBR through the reduction of structural lag. While LTM ROE stands at 8.4% (with structural lag comprising ~120bps), mgmt expressed near-term O&M levels as an exception given push-out benefit with negative impact to 4Q/1Q21 ahead. As such, mgmt expects PBR resolution of structural lag potentially supporting towards a 9.0% earned ROE relative to a lower than 3Q normalized baseline ROE.

In terms of PBR discussions, mgmt expressed positives as support for earning sharing mechanisms (ESM) including both positive and negative, potentially with sharing in under-earning as well. Additionally, mgmt expressed focus on incentive PIMs with a range being established. Accelerating the annual accrual date for RAM to Jan 1 annually from June 1 also helps with structural lag. That said, 'day-1 savings' will likely be a focus as well, with Consumer Advocate proposing 4x cumulative value of accelerated RAM accrual relative to HE proposing the already committed $25mn by 2022 reduction.

Mgmt continues to expect a final PUC decision for PBR Phase II in Dec. That said, mgmt emphasizes specific rate tariffs will be established to implement new and gauged mechanisms after the order, as a new step by the PUC. As such, the timeline to reduce structural lag remains unclear. With potentially multi-year targets, mgmt expressed the extent of which under-earning can be mitigated in 2021 remains contingent on PBR results. Nonetheless, we perceive potential upside relative to earned ROE reflected in the low 8% range in our forecast but emphasize need for execution.

ASB remains cautious with yet further NIM compression likely ahead

On the other hand, ASB discussions remained cautious. With continued NIM compression into 3Q already at 3.12% (vs. 2Q/1Q NIM of 3.21%/3.72%), mgmt expressed further pressure ahead relative to already below-expectation 3Q levels. This is primarily driven by the spread between higher rate existing loans rolling off and being replaced by new customer loan agreements at lower rates, with mgmt expressing a slow but gradual continued decline in NIMs likely as long as interest rates are lower relative to a year prior. With rates expected to remain low through the near-term, we expect continued pressure at the ASB segment. While, mgmt did not explicitly guide expectations for lower NIM relative to 3.12% in 3Q into 2021, noting variables including potential for higher margin mix as well, downward pressure on existing vs. new pricing remains.

For loan loss provision, mgmt continues to express uncertainty, though noting it exercises conservatism in projecting potential loan losses. If actual net charge offs are ultimately less than what is provisioned for ASB could see some provision come back. Mgmt expresses YTD provision largely in-line with its expectations. However, mgmt notes this could worsen if additional lockdown and economic pressures worsen (with economic impact with sustained tourism reopening uncertain).

MGE Energy (MGEE)

MGEE mgmt. expressed confidence in its near-term regulatory outlook with the pending decision of its WI rate case settlement expected before the end of the year. While capex shifted incrementally during the 2020-22 period it still remains elevated as MGEE works to complete its utility scale solar build at Badger Hollow and Two Creeks. Ahead of the roll-forward of its 3-year capex plan to be rolled out with the Q4 results, we look ahead to potential updates on further generation spend (particularly given WEC's confirmation of the exercise of its West Riverside option) though see these as mid-2020s items. Maintain Underperform on MGEE.

Generation investment needed by mid-decade

MGEE is in the process of completing 170 MW of utility scale solar at its Badger Hollow, Two Creeks, and O'Brien facilities with all targeted for completion by 2022. Unlike WEC, which confirmed its intention to exercise the option it holds to purchase an incremental 200 MW of generation capacity at LNT's recently opened West Riverside facility for total capex of $180m, MGEE did not confirm its plans with the option it holds for 50 MW (with option good until 2025). While the *specific* generation addition plans remain to be determined, MGEE mgmt. reiterated that it does see investment opportunities in new generation by the mid-2020s with expected upcoming retirements of gas combustion turbines (75 MW), Blount Generating (94 MW), and expiring PPAs (50 MW). We perceive that MGEE mgmt. is holding off on making fuel type decisions for its future generation fleet until necessary investments are required, rather than committing to a specific fuel now (such as gas as a bridge to renewables). While we do see a step-down in capex in the 2023+ timeframe following the placement in service of the current crop of renewables, we note there is mid-decade upside from the next tranche of generation spend, as well as incremental opportunities such as deployment of advanced meters.

Looking constructive on WI rate settlement

The Wisconsin electric 2021 rate settlement remains pending with the commission, though mgmt. indicates confidence in achieving a final order before year-end. Under the proposal rates would remain flat at the electric utility along with a 4% increase in gas rates, with a tightening of the fuel cost bandwidth to 1% from 2%, with an expected continuation of the ROE and authorized equity layer. With the majority of stakeholders in the proceeding signing off on the proposed settlement, we see a constructive outcome as more likely than not.

Storage co-investment opportunities with WEC, others

Following fellow WI utility WEC's update which is targeting 600 MW of rate base storage rollout through its forecast period, MGEE sees opportunities for co-investment, in particular in storage attached to co-owned projects (Badger Hollow, Two Creeks). Intriguingly, the opportunity extends beyond pairing storage with generation assets to the distribution system as well, though specific projects and investment sizes were not included in MGEE's update. As with additional generation investment, we see storage co-investment as a potential area to watch though likely in the 2022+ timeframe (beyond the current capex forecast).

Stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
LNT	LNT US	Alliant Energy Corp	US$ 57.42	B-1-7
AY	AY US	Atlantica Sustain	US$ 33.87	B-2-7
ED	ED US	Consolidated Edison	US$ 81.72	A-2-7
WTRG	WTRG US	Essential Utilities	US$ 46.37	B-1-7
ES	ES US	Eversource Energy	US$ 94.42	C-2-8
HE	HE US	Hawaiian Electric	US$ 37.05	A-3-7
MGEE	MGEE US	MGE Energy	US$ 72.16	A-3-7

Source: BofA Global Research

Price objective basis & risk

Alliant Energy Corporation (LNT)

Our $61 PO is based on a sum of the parts analysis employing relative premium and discounts to the large cap regulated peer multiple of 16.8x 2023E P/E. We note that electric peer P/E multiple is grossed up for a year by 5% to reflect capital appreciation across the sector. We apply a 3.0x P/E premium on IPL as we see the rate case overhang being resolved. We apply a 4.0x P/E premium on Eastern Wisconsin Electric Company reflecting 1) low risk investment nature of the state, 2) above average ROEs, 3) higher than average growth runway for investments, and 4) bad debt deferral. At ATC, we reflect a 2.0 x P/E premium on LNT's 16% share in the transmission company. Growth expectations for this segment are high, paired with above average ROEs that we believe face less downward pressure vs. regulated state distribution ROEs. We apply an in line multiple at the parent to account for the blend of numerous businesses some which benefit from long term stable PPAs via intercompany generation. Risks to our price objective are: 1) adverse rate case outcomes, 2) further equity dilution beyond our estimates, 3) interest rate risk, 4) natural disasters, and 5) lower allowed ROEs.

Atlantica Sustainable Infrastructure (AY)

Our $33/sh PO is based 50% on a DCF valuation and 50% on our Growth approach. Our Growth value is $36 (weighted 50%). Our DCF value is $29.00 (weighted 50%).

Assumptions in our DCF valuation are:
- A 7.0% discount rate based on a CAPM methodology assuming a 0.6% risk free rate and a 5.5% equity risk premium
- 2% annual escalator in corporate expenses

Main assumptions in our Growth valuation are:
- Run-rate CAFD generated by the current portfolio of $213 Mn
- 750 MW of future drop downs
- A target payout ratio of 80%

Downside risks are 1) the company may not be able to access capital markets at favorable terms, 2) the company may not be able to make accretive acquisition opportunities to fuel growth, 3) the company may not be able to grow DPS at the targeted growth rate, 4) the company may not be able to sustain its current dividend levels, and dividend yield could increase.5) PCG related counterparty exposure is among the nearest exposures to watch.

Consolidated Edison (ED)

Our $82 PO is based on a sum-of-the-parts analysis applying premiums and discounts to the regulated group multiples (16.6x/14.0x for electric/gas respectively) with a -1.0x discount on both Steam & Electric to reflect Covid recovery overhang. Steam for lack of decoupling. Both electric and gas peer P/E multiples are grossed up for a year to 2021 by 5% to reflect capital appreciation across the sector. We applied inline peer regulated multiple at CECONY despite its rate certainty for conservatism as our higher capex expectations are reflected in our EPS outlook. We apply a discounted PE for infrastructure projects given the lack of clarity around the capital structure. We further apply an EV/EBITDA approach on 2023E EBITDA to the CEB business using a 10.0x multiple for both the legacy portfolio and the renewables portfolio seeing it as having higher quality returns.

Downside risks: ED, like all utility stocks, is also sensitive to changes in the market level of interest rates. Utilities historically underperform if bond yields rise, and outperform when they fall. Further downside risks are the inability to recontract storage, adverse regulatory outcomes, a deteriorating regulatory environment, or unforeseen disasters such as the Harlem gas explosion, the SRE transaction not being completed. Customer inflation is also a downside risk. PCG related counterparty exposure is among the nearest exposures to watch.

Essential Utilities (WTRG)

Our price objective is $51 based on our SOTP approach, applying a peer multiple to the water utility and gas utility, respectively and accounting for expected growth for each sector. These peer multiples are 25.5x and 13.9x. We apply a 3.0x premium to Peoples Gas given the organic growth opportunities, while applying a variety of premiums to its water (2x previously) subsidiaries: +4x to PA, +3x to IL, +2x to OH, +2x for TX, +2x for OH, and no premium for balance of biz. We net out parent debt and parent interest expense associated with parent debt 50/50 weighed basis.

Risks to the downside are acquisition risk, deteriorating regulatory outcomes, and risks from a lower rerating following the diversification into gas.

Eversource Energy (ES)

Our sum of the parts based price objective of $95 uses P/E multiples on 2023E earnings. For electric utilities, we attribute a 4x premium NSTAR, and 3x premium to PSNH and CL&P to peer 17.3x multiple, reflecting future potential positive revisions to capex and earnings. For gas, we apply a 3x premium to the peer 15.3x multiple, given capex upside particularly in MA and a 2x for Columbia Gas. Both electric and gas peer P/E multiples are grossed up by 5% to reflect capital appreciation across the sector. We value Aquarion at a 1x premium to the 27.5x water multiple. We reflect ES's 50% ownership in Revolution and South Fork offshore wind sites on an NPV basis. We take out 50% of parent debt, and 50% of interest to accurately reflect parent leverage.

Upside risks to our price objective are additional capex announcements on the T&D side, as well as success in offshore wind RFPs.

Downside risks are reduction in authorized ROEs, inability to meet earned ROE expectations, as well as failure to receive permitting on incremental capex opportunities

Hawaiian Electric Industries (HE)

Our PO of $34 for Hawaiian Electric Industries is based on a sum of the parts approach. We apply: 1) a 2023E forward P/E multiple in line with electric utility peer multiple of 16.9x. We see this as justified given ongoing issues in the regulatory environment need to be resolved and the earnings gap vs what is required to achieve authorized ROEs across all three of the jurisdictions. Electric utility peer P/E multiple is grossed up for a year to 2020 by 5% to reflect capital appreciation across the sector, 2) a 2021E forward price to tangible book value of 1.50x to the banking subsidiary, a 0.5x premium to smid cap regional peers (0.96x), in-line with Hawaiian banks peers due to outperformance. We then take into account parent overhead by applying the same multiple here as to the utility segment to 50% of parent interest and subtracting the per share value of the remaining 50% of the debt. Downside risks are delays on capital expenditures, weakening regulatory environment, PUC denial of new capital investments or lower authorized ROEs. Upside risks are expansion of capital expenditure plan, significant improvements in earned and/or authorized ROEs

MGE Energy (MGEE)

Our $62 PO is based on a sum-of-the-parts analysis applying premiums and discounts to the regulated group multiples (16.5x/13.9x for electric/gas respectively) with a 4.0x premium on WI regulated gas and electric to reflect the constructive regulatory mechanism, and a 2.0x premium on Transmission assets. We note that both electric and gas peer P/E multiples are grossed up for a year to 2021 by 5% to reflect capital appreciation across the sector. We apply utility premiums to the non-regulated Elm Road and West Campus assets as these are leased under long-term contractual arrangements. Downside risks: MGEE, like all utility stocks, is sensitive to changes in the market level of interest rates. Utilities historically underperform if bond yields rise, and outperform when they fall. Further downside risks are the inability to secure further renewable rate base investments, adverse regulatory outcomes, a deteriorating regulatory environment, or adverse weather leading to less consumption of electricity and gas. Upside risks are acceleration of renewable gen investment, legacy coal asset early retirement, and enactment of further pro-renewable state policies.

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North American Utilities, Alternative Energy & LNG Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	Alliant Energy Corporation	LNT	LNT US	Julien Dumoulin-Smith
	AltaGas	YALA	ALA CN	Julien Dumoulin-Smith
	Atmos Energy Corporation	ATO	ATO US	Richard Ciciarelli, CFA
	Clearway Energy	CWENA	CWEN/A US	Julien Dumoulin-Smith
	Clearway Energy	CWEN	CWEN US	Julien Dumoulin-Smith
	CMS Energy	CMS	CMS US	Julien Dumoulin-Smith
	DTE Energy	DTE	DTE US	Julien Dumoulin-Smith
	Duke Energy	DUK	DUK US	Julien Dumoulin-Smith
	Edison International	EIX	EIX US	Julien Dumoulin-Smith
	Emera Inc	YEMA	EMA CN	Julien Dumoulin-Smith
	Enphase Energy	ENPH	ENPH US	Aric Li
	Entergy	ETR	ETR US	Julien Dumoulin-Smith
	Essential Utilities	WTRG	WTRG US	Julien Dumoulin-Smith
	Evergy, Inc	EVRG	EVRG US	Julien Dumoulin-Smith
	FirstEnergy	FE	FE US	Julien Dumoulin-Smith
	Hydro One	YH	H CN	Julien Dumoulin-Smith
	Idacorp	IDA	IDA US	Julien Dumoulin-Smith
	NextEra Energy	NEE	NEE US	Julien Dumoulin-Smith
	NiSource Inc	NI	NI US	Julien Dumoulin-Smith
	NRG Energy	NRG	NRG US	Julien Dumoulin-Smith
	OGE Energy Corp	OGE	OGE US	Julien Dumoulin-Smith
	PG&E Corporation	PCG	PCG US	Julien Dumoulin-Smith
	Portland General Electric Company	POR	POR US	Julien Dumoulin-Smith
	PPL Corporation	PPL	PPL US	Julien Dumoulin-Smith
	Public Service Enterprise Group	PEG	PEG US	Julien Dumoulin-Smith
	Sempra Energy	SRE	SRE US	Julien Dumoulin-Smith
	Spire	SR	SR US	Richard Ciciarelli, CFA
	Sunnova Energy	NOVA	NOVA US	Julien Dumoulin-Smith
	SunRun	RUN	RUN US	Julien Dumoulin-Smith
	Vistra Energy	VST	VST US	Julien Dumoulin-Smith
NEUTRAL				
	Ameren Corporation	AEE	AEE US	Julien Dumoulin-Smith
	American Electric Power	AEP	AEP US	Julien Dumoulin-Smith
	Atlantica Sustainable Infrastructure	AY	AY US	Julien Dumoulin-Smith
	Avista	AVA	AVA US	Richard Ciciarelli, CFA
	Black Hills Corporation	BKH	BKH US	Julien Dumoulin-Smith
	CenterPoint Energy	CNP	CNP US	Julien Dumoulin-Smith
	Cheniere Energy Inc	LNG	LNG US	Julien Dumoulin-Smith
	Consolidated Edison	ED	ED US	Julien Dumoulin-Smith
	Dominion Energy	D	D US	Julien Dumoulin-Smith
	Eversource Energy	ES	ES US	Julien Dumoulin-Smith
	First Solar, Inc.	FSLR	FSLR US	Julien Dumoulin-Smith
	Hannon Armstrong	HASI	HASI US	Julien Dumoulin-Smith
	NextDecade	NEXT	NEXT US	Julien Dumoulin-Smith
	NextEra Energy Partners	NEP	NEP US	Julien Dumoulin-Smith
	ONE Gas, Inc.	OGS	OGS US	Richard Ciciarelli, CFA
	Southern Company	SO	SO US	Julien Dumoulin-Smith
	Southwest Gas Holdings	SWX	SWX US	Richard Ciciarelli, CFA
	Tellurian Inc	TELL	TELL US	Julien Dumoulin-Smith
	TransAlta Renewables Inc.	YRNW	RNW CN	Julien Dumoulin-Smith
	Unitil Corporation	UTL	UTL US	Julien Dumoulin-Smith
	Xcel Energy Inc	XEL	XEL US	Julien Dumoulin-Smith
UNDERPERFORM				
	Algonquin Power & Utilities Corp	AQN	AQN US	Julien Dumoulin-Smith
	Algonquin Power & Utilities Corp	YAQN	AQN CN	Julien Dumoulin-Smith
	American Water Works	AWK	AWK US	Julien Dumoulin-Smith
	Avangrid	AGR	AGR US	Julien Dumoulin-Smith
	Bloom Energy	BE	BE US	Julien Dumoulin-Smith
	Exelon	EXC	EXC US	Julien Dumoulin-Smith
	Fortis	YFTS	FTS CN	Julien Dumoulin-Smith
	Fortis Inc	FTS	FTS US	Julien Dumoulin-Smith
	Hawaiian Electric Industries	HE	HE US	Julien Dumoulin-Smith
	MGE Energy	MGEE	MGEE US	Julien Dumoulin-Smith

North American Utilities, Alternative Energy & LNG Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	New Jersey Resources Corp	NJR	NJR US	Richard Ciciarelli, CFA
	Northwest Natural Holdings	NWN	NWN US	Richard Ciciarelli, CFA
	NorthWestern Corporation	NWE	NWE US	Julien Dumoulin-Smith
	Pinnacle West	PNW	PNW US	Julien Dumoulin-Smith
	South Jersey Industries	SJI	SJI US	Richard Ciciarelli, CFA
	SunPower Corp.	SPWR	SPWR US	Julien Dumoulin-Smith
	WEC Energy Group Inc	WEC	WEC US	Julien Dumoulin-Smith

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Important Disclosures

Equity Investment Rating Distribution: Utilities Group (as of 30 Sep 2020)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	79	51.63%	Buy	59	74.68%
Hold	36	23.53%	Hold	24	66.67%
Sell	38	24.84%	Sell	25	65.79%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2020)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1749	54.79%	Buy	1114	63.69%
Hold	677	21.21%	Hold	415	61.30%
Sell	766	24.00%	Sell	386	50.39%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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